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NOTES AND MEMORANDA.

THE MASSACHUSETTS ANTI-STOCK-WATERING LAW.

One of the most significant and important acts of the Massachusetts legislature of 1908 is an amendment to the law affecting the conditions under which certain classes of public service corporations may issue increased shares of capital stock. The anti-stock-watering laws of Massachusetts have successfully withstood the pressure of commercial expansion and industrial development for the past fifteen years. The test of declining values and hard times has been reserved until now. The legislature has finally yielded in part to the demands of the public service corporations of Massachusetts for greater elasticity in the issue of shares of increased capital stock.

Since 1870 Massachusetts has attempted in three ways to regulate the issue of stock of public service corporations, and a fourth method has been adopted this year as to transportation companies. Before 1871 issues of increased capital were to be made at their par value. In 1871 railroad corporations were required to offer all stock worth more than par at public auction; and this was soon extended to street railway companies. In 1878 the law was re-established as it had stood before 1871, and no substantial change was made for fifteen years. It is significant that, under this law of 1878, stockholders' subscriptions were limited by the terms of the statute to the par value of the stock. The only way in which the stock could be sold at a premium was by public sale.

In 1893 a radical change was made. Instead of requiring increased capital, if offered for subscription of stockholders,

to be sold at par and at no other price, no increased capital could be issued, in excess of 4 per cent. of the existing capital stock, without first being offered to stockholders "at the *market* value thereof at the time of increase," to be determined by the board of railroad commissioners after "taking into account previous sales of stock of the corporation and other pertinent conditions." The directors were required to sell at public auction any shares not subscribed for, and in no case could stock be sold by subscription or by auction at less than par. At first this act applied only to transportation companies, but in 1904 it was extended to include all classes of public service corporations.

The railroad commissioners evidently considered that the current quotation was the controlling condition in determining the market value of stock. At any rate, the board early adopted the policy of fixing a subscription price based on market quotations, somewhat lower, to be sure, than the current quotations of listed stock, but with only sufficient margin to make a sale of a substantial block of stock at the ruling quotations reasonably secure. This policy the railroad commission for fifteen years steadfastly maintained.

Since the enactment of the law of 1893 the steam roads have increased their capital three times by issues exceeding 4 per cent. of their existing capital. These increases were as follows: in 1899 by the Norwich & Worcester at 215; in 1901 by the Boston & Maine at 190; and in 1906 by the Boston & Maine at 165. All of the above issues were fully subscribed by stockholders except the 1906 issue of the Boston & Maine. The steam roads have also increased their capital fifteen times by issues of less than 4 per cent., the increased stock being sold at auction with large premiums. The street railways have applied 207 times for increases of capital, of which 153 have been authorized at par, and 54 at a premium.

Until recent years few complaints have been made by the corporations or by their stockholders. Handsome

premiums have been obtained from stockholders, the issues have been fully subscribed, and the "rights" have found a ready and a profitable market. But of late the popularity of this method of raising additional capital has ceased. Stockholders have subscribed to new stock only to find that a declining market has turned the privilege of subscription into an unprofitable investment. The last issues of stock of Massachusetts railroad corporations were only partly subscribed for, and it was realized that some change in the law must be effected before the experiment could successfully be tried again.

The greatest possible pressure has been brought to bear on this year's legislature to secure legislation which would shift the responsibility of fixing the terms of subscriptions for increased capital from the railroad commissioners to the corporation. All of the larger public service corporations united in urging this change, and their efforts were supplemented by a favorable recommendation from the Commission on Commerce and Industry. In its original form the bill introduced for this purpose applied to all classes of public service corporations. In brief, it proposed to permit public service corporations to offer increased stock for subscription by stockholders at such price, not less than par, as might be determined by the directors. The only duty of the railroad commissioners was to determine whether or not the amount of the proposed issue was reasonably necessary for the purposes for which the issue was authorized.

As reported by the railroad committee and as enacted, the act is limited to transportation companies. The price at which the stock is to be issued is to be fixed by the stockholders, and not by the directors of the corporation. And in addition to the power of determining the size of the issue necessary to accomplish the contemplated purposes, the board of railroad commissioners is given authority to "refuse to approve any particular issue of stock if, in the opinion of the board, the price fixed by the stockholders is so low as to be inconsistent with the public interest."

The primary purpose of the Act of 1893 (with its extension in 1904 to all public service corporations) was to protect the public against partial stock dividends in the form of the distribution of stock at par which would have sold at public sale at a premium largely in excess of par. It so happened that this change in the law was made at a time of great financial depression, when the general trend of values was toward higher levels. For more than ten years stockholders found that investments in increased stock at market quotations became profitable investments because of the general appreciation in value of securities of all classes. The experience of Massachusetts public service corporations during the past three or four years, however, has demonstrated an inherent weakness in this scheme of regulating the issue of increased capital. It will only be effective as a means of raising capital when it is least needed; that is, when the securities will sell themselves on the basis of their own intrinsic value. Whenever the co-operation of stockholders is really required in periods of financial depression, such co-operation can only be secured by offering more substantial inducements than are afforded by subscriptions at a price approximating current quotations.

All legislation regulating the issue of stock of public service corporations must recognize the primary necessity of affording to capital such return as is normal under conditions as they exist at the time of investment. These conditions change almost daily, and show extreme fluctuations every ten or fifteen years. Obviously, great elasticity is required under such circumstances in any attempt to define what shall be a fair return to the investor, while at the same time protecting the public against the undue capitalization of public service corporations.

The experience of Massachusetts during the past thirty-eight years in dealing with the perplexing problem of how to regulate the issue of increased stock by public service corporations may be summarized by briefly reviewing in chronological order the four plans which have been actually adopted:—

1. No increased stock shall be issued except at par. This is unfair both to the corporation and to the public. It often deprives the former of a premium which the stock would bring at public sale, and as often effects a partial stock dividend which is contrary to the public interest.

2. All increased stock shall be sold at auction. This is the generally accepted method of determining intrinsic value under any and all conditions. It certainly will protect the public, but it is not always in the interest of the corporation or its stockholders. Traditionally and usually legally, stockholders are entitled to the first opportunity to secure the increased stock of their own corporation on terms at least as favorable as the investing public will offer. Under some circumstances it may be for their interest to accept less favorable terms, altho the recent experience of Massachusetts corporations does not indicate that this is generally appreciated. Finally, sales of large blocks of stock at auction may afford an opportunity to interests hostile to the corporation to secure a substantial voice in its affairs.

3. Increased stock shall be offered to stockholders only at its actual market value. This will safeguard the public interest, but it will be an effective method of securing additional capital in substantial amounts only under favorable financial conditions. In periods of depression, when the co-operation of stockholders is most needed, substantial concessions from the current market price must be made in order to insure the investment of new capital.

4. Increased stock shall be offered for subscription at a price not less than par, to be determined by the stockholders subject to the approval of the railroad commissioners. This should be satisfactory to the stockholders and to the corporation. Unless controlled by their own good sense or by the supervision of the railroad commissioners, however, this plan, now on trial in Massachusetts, will offer the temptation to stockholders at periods of corporate prosperity to issue to themselves stock on substantially more favorable terms than conditions then existing require. Should this

practise become general, the public interest will require all issues of increased stock to be advertised and sold at public auction, and not otherwise.

GROSVENOR CALKINS.

BOSTON, MASS.

PROFESSOR CARVER'S CONCEPT OF AN ECONOMIC QUANTITY.

To one who has long been accustomed to follow with pleasure and confidence the careful footsteps of Professor Carver as he leads the way through difficult mazes of economic material or as he makes straighter the old and badly made paths, it comes with a distinct shock of surprise that in his article on The Concept of an Economic Quantity¹ the customary leading is no longer vouchsafed.

Professor Carver begins with a discussion of what he believes to be a fallacy in Walker's contention that money is rather a denominator than a measure of value; that "a measure, a relation, a ratio, cannot be measured. You do not measure the relation of a mile to a furlong: you express it as 8:1. You use a common language for the two quantities. You take a common term or denominator for the two distances, and thus set them in immediate comparison with each other"; that money serves "merely to name the relation between the values of things rather than to measure their value." And Professor Carver thinks that "an examination of Walker's argument will serve as a good introduction to the general question of the meaning and significance of an economic quantity."

A careful reading and rereading of the "examination" leaves me convinced that the fallacy is with Carver rather than with Walker. As I understand the Walker thesis, it is substantially as follows: The use of the phrase "measure of value" is misleading, since the word "measure" is so com-

¹ Quarterly Journal of Economics, May, 1907.